

## THE DETERMINANTS AFFECTING FRAUD TRENDS

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### ABSTRACT

*This study aims to examine the determinants that influence the tendency of fraud in medium-sized companies in Yogyakarta. The variables used in this study are ethics, compensation conformity, leadership style, and fraud. The population in this study is medium-sized companies in Yogyakarta. Sampling is done by using purposive sampling method. The sample used is the staff of medium-sized companies in Yogyakarta. The research model uses SmartPLS 2.0 in processing data. The results of this study show that ethics has a negative effect on fraud; compensation conformity has a negative effect on fraud; and leadership style has a negative effect on fraud.*

### 1. INTRODUCTION

Fraud, particularly in financial sector, has been spreading across all aspects of life, in which all lines have been affected by corruption. Indonesia is one of the most corrupt countries in the world. According to the Corruption Perception Index (CPI) 2014, published globally by Transparency International, Indonesia is a country with a high level of corruption. In the CPI 2014, Indonesia is ranked 117th out of 175 countries in the world, with a score of 34 in a scale of 0-100 (0 = very corrupt and 100 = very clean). Corruption occupies the top position out of 18 (eighteen) factors inhibiting the ease of business in Indonesia.

Fraud is a deliberate or careless act in doing or not doing something as it should be so that financial statements become materially misleading (Tuanakotta, 2010). Detecting fraud is not an easy task because it requires a comprehensive knowledge related to the characteristics and ways of doing fraud. According to Kassem and Higson (2012) the detection of fraud does not always get a bright spot due to the various underlying motivations and methods of doing fraud. The above information confirms that an auditor desperately needs an indicator, commonly

called *red flag*, to detect the fraud risk. Red flag is a potential symptom that requires more in-depth investigation, which indicates a higher risk of deliberate misstatement in financial statements. It can also be said that red flag is an early warning signal to reduce the risk of being undetected by auditors. SAS No. 99 requires external auditors to use 42 red flags in detecting possible fraud (Moyes 2006).

Fraud can be detected by looking at the determinants that affect the occurrence of fraud. However, it is inevitable that fraud risk still continues to happen in company. Fraud risk occurring in company can be prevented by applying ways as disclosed by Amrizal, (2011), such as examining and assessing the adequacy of the application of the management control system, internal control structure, and other operational control systems, developing effective control systems at the most appropriate and efficient cost, ensuring compliance with policies, plans and procedures established by management, and ensuring the reliability of the data management developed within the organization.

This research was conducted by exploring the perception of fraud trend in the Regional-Owned Enterprises in Yogyakarta and some factors that influence it. These factors include ethics, compensation conformity and leadership style.

The problems to be discussed in this research are formulated in the form of research questions as follows:

1. Does ethical behavior have an effect on the trend of fraud?
2. Does compensation conformity have an effect on the trend of fraud?
3. Does leadership style have an effect on the trend of fraud?

The purpose of this study is to find out the effect of the determinants, such as ethics, compensation conformity and leadership style, on the trend of fraud.

## 2. THEORETICAL BASIS AND HYPOTHESIS DEVELOPMENT

### Fraud

In general, fraud involves a variety of meanings. By utilizing his intelligence, man can plan to gain profit through the wrong description. Fraud is a deliberate or careless act in doing or not doing something as it should be so that financial statements become materially misleading (Tuanakotta 2010). Meanwhile, the Association of Certified Fraud Examiners (ACFE) describes the branches of fraud as the form of a working relationship scheme resembling a tree and its twigs. There are three main branches, namely Corruption, Asset Misappropriation, and Fraudulent Statements

#### 1. *Asset Misappropriation*

Asset misappropriation involves the misappropriation / theft of a company's or other parties' assets or properties. This is the most easily detectable form of fraud because it is tangible or can be measured.

#### 2. *Fraudulent Statements*

Fraudulent statements include actions taken by an officer or executive of a company or government agency to cover the actual financial condition by performing financial manipulation in presenting the financial statements for profit. One form of fraudulent statements is earnings management (Rezaee, 2002).

#### 3. *Corruption*

Corruption is prevalent in countries that have a weak law enforcement system, and a lack of awareness of good governance so that the integrity factor is questionable. This type of fraud is the most difficult to detect because it involves cooperation with other parties such as bribery and corruption that have a symbiotic relationship of mutualism.

### **Factors Affecting Fraud Trend**

From the above explanation there are several factors that can affect the trend in fraud, such as:

#### **Ethics**

According to Wilopo (2006), ethics is something that is difficult to understand, in which the answer depends on the complex interaction between the situation and the personal characteristics of the doers. Although it is difficult in the context of accounting and its relationship to the market is also often unclear, modeling behavior needs to be considered in order to improve the quality of decisions and reduce costs related to information, and improve the availability of information existing in the market (Hendriksen, 1992). Tang (2003) in his research describes distorted or unethical behavioral indicators in the company. According to Kusumastuti (2012), this ethics consists of abuse of power, abuse of position, abuse of resources, and no action)

#### **Compensation**

Odunlade, R.O (2012) discloses that the grant of compensation refers to all other forms of remuneration and other tangible benefits an employee receives in return for the employee's performance for the company. According to Dessler (1997), compensation refers to all forms of wages or benefits received by employees arising from work they have accomplished well, and have two main components of direct and indirect payments. Direct payments are usually in the form of overtime wages, basic salaries, premiums, incentives, commissions, bonuses, and benefits. Indirect payments are usually in the form of financial benefits such as insurance and holiday allowances paid by company, praise, oral appreciation, and a sense of security.

Odunlade, R.O (2012) says that employee compensation consists of basic salary and benefits. Meanwhile, McNamara

(2008) considers more detailed compensation that includes issues related to wages or salary programs and structures derived from job descriptions, service-based programs, bonus-based programs, commission-based programs and so on. According to Rabindra, N. and Medonca (in Nugraha, 2010), compensation conformity is the level of conformity to all forms of return both financially and non-financially received by employees due to the services donated to the company.

#### **Type of Compensation**

According to Hasibuan (2007), compensation is divided into two:

##### **a. Direct Compensation**

Direct compensation consists of:

- 1) Salary: remuneration paid periodically to permanent employees and has the right insurance.
- 2) Wages: remuneration paid to daily workers on the basis of an agreement.
- 3) Incentive wages: additional money paid to certain employees whose performance is above the standard performance.

##### **b. Indirect Compensation**

Indirect compensation consists of employee protection, employee benefits, and employee comfort. In providing compensation, it is necessary to apply principles that can facilitate the company in the process of providing compensation to employees. These principles, according to Siagian (2008), are as follows:

##### **a. Principle of Justice**

Determining the principle of justice is not easy. So, it is necessary to use four comparative criteria:

- 1) Assessing whether the rewards received are appropriate or not with the expectation.

- 2) Comparing the rewards he or she has received while working elsewhere.
- 3) Comparing the amount and type of benefits received with those received by a co-worker under the same qualified assumptions.
- 4) Comparing with reward system in other companies in the same field.

#### **b. Principle of Fairness**

This means that the amount of compensation provided allows the employee and his family to maintain a proper lifestyle in accordance with their social position and dignity in the company and in society.

#### **c. Principle of Equality**

If the labor market applies a specified wage and salary rate, among others through the agreement of the labor user association, this principle will be easy to implement.

#### **d. The Principle of Organizational Capability**

In granting compensation, the company should consider its own ability, because the compensation must be adjusted to the company's financial condition.

#### **Leadership Style**

Leadership is a tool that arranges an organization to achieve the goals of the company (Johannes, 2016). Thus, many management experts put forward various opinions on the definition of leadership. As stated by Hasibuan (2009), the leadership set by a manager in the organization can create a harmonious integration and encourage employee enthusiasm to achieve maximum goals. Leadership is the way how a leader influences the behavior of subordinates to be willing to work together and work productively to achieve organizational goals.

According to Adair (2010), leadership is specific in accordance with the particular situation observed. Those who become the leaders of a particular group must engage in a particular activity, and the leadership characters that play a role in a particular case are a function of a specific situation. At the same situation, there are different characteristics of individuals who become leaders and, at the different situation, the differences in the characteristics will be even greater. Wursanto (2003) provides the formulation that leadership is an activity affecting others to work together to achieve certain desired goals.

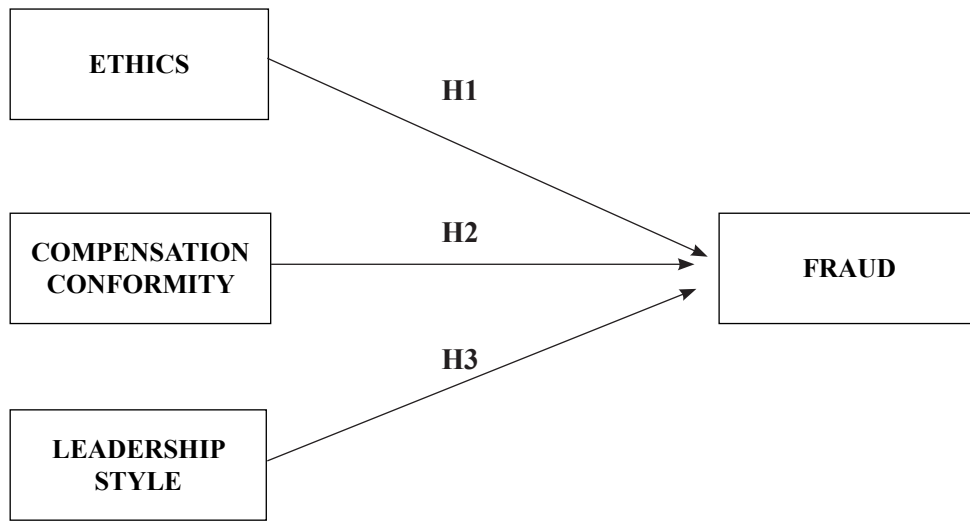
The leadership style is the style of leadership brought about by a leader in influencing his followers. The style of a leader in carrying out his leadership is influenced by various patterns (Wursanto, 2003), such as education pattern, experience pattern, age pattern, and character pattern. A leader who does not master the field of duty existing in his authority will submit everything to his subordinates, so that his leadership style is called *Laissez faire* (Prasastono, 2012).

#### **Hypothesis Formulation**

From the explanation above, the hypotheses can be formulated as follows:

- H1: Ethics has a negative effect on the trend of fraud.
- H2: Compensation conformity has a negative effect on the trend of fraud.
- H3: Leadership style has a negative effect on the trend of fraud

**Figure 1**  
**Framework**



#### 4. RESEARCH METHOD

The research method used is survey method. Survey method is the primary data collection method between researchers and respondents. Data collection using survey method is designed to explain the cause and effect relationship.

Due to limited time and cost, the object of this research is only focused on medium-sized companies located in Yogyakarta. Besides, the author assumes that the existence of medium-sized companies existing in in Special Region of Yogyakarta (DIY) can thoroughly become national benchmark.

This research uses 2 data processings: descriptive analysis and analytical analysis. Analysis related to the explanation of various behavioral variables is done by using descriptive analysis based on various relevant theories and approaches. Analysis that has interrelationship between various variables is done by using statistical test approach in the form of simultaneous equation model (SEM) which is assisted by smartPLS application program version 2.0.

#### 5. DATA ANALYSIS AND DISCUSSION

##### Validity Test

Validity test in this research involves convergent validity and discriminant validity. Individual reflective measure is said to be high if it has correlated value of more than 0.5. (With significance level of 0.05 and T statistic value > 1.64).

Meanwhile, the validity test that involves discriminant validity is done by comparing the AVE (average variance extracted ) square root value of each construct with the correlation between the construct and the other constructs in the model. If the AVE square root of each construct is greater than the correlation value between the construct and the other constructs in the model, it has a good discriminant validity value.



**Table 4.4**  
***Initial Item Loadings and AVE***

Variable	Items of Question	Code	Loading	AVE
Ethics (ETC)	Use of official vehicles	ETC1	0.508	0.319
	Photocopy for personal use	ETC2	0.525	
	Taking a vacation using office facilities	ETC3	0.753	
	Employee attitude toward harmful action	ETC4	0.714	

Variable	Items of Question Item	Code	Loading	AVE
Compensation Conformity (COM)	Compensation based on achievement	COM1	0.625	0.344
	Individual responsibility	COM2	0.543	
	Promotion based on achievement	COM3	0.536	
	The company is managed by using good management	COM4	0.732	
	Timely financial statements	COM5	0.635	
	Compatibility between work and expertise	COM6	0.647	

Variable	Items of Question	Code	Loading	AVE
Leadership Style (LDS)	Leadership firmness	LDS1	0.662	0.524
	Work instructions on subordinates	LS2	0.513	
	Delegation of authority	LDS3	0.637	
	Openness in getting advice	LDS4	0.543	
	Giving bonus by superiors	LDS5	0.542	

Variable	Items of Question	Kode	Loading	AVE
Fraud (FRD)	Decreasing the cost on the report	FRD1	0.504	0.435
	Eliminating bookkeeping documents	FRD2	0.540	
	Minimizing reserve receivables	FRD3	0.642	
	Receiving fictitious payments	FRD4	0.588	
	Courage to reject unnatural requests	FRD5	0.579	

**Table 4.5**  
***Cross Loading***

	ETC	COM	LDS	FRD
ETC1	0.714	0.437	0.549	0.296
ETC2	0.761	0.447	0.503	0.195
ETC3	0.738	0.414	0.456	0.296
ETC4	0.716	0.166	0.626	0.486
COM1	0.251	0.778	0.225	0.104
COM2	0.366	0.746	0.301	0.109
COM3	0.362	0.754	0.340	0.444
COM4	0.283	0.709	0.235	0.080
COM5	0.316	0.766	0.826	0.586
COM6	0.710	0.747	0.703	0.195
LDS1	0.638	0.414	0.756	0.296
LDS2	0.416	0.166	0.826	0.286
LDS3	0.103	0.251	0.729	0.706
LDS4	0.517	0.166	0.826	0.786
LDS5	0.366	0.166	0.856	0.186
FRD1	0.713	0.241	0.625	0.697
FRD2	0.701	0.239	0.630	0.897
FRD3	0.418	0.166	0.326	0.756
FRD4	0.623	0.241	0.625	0.697
FRD5	0.573	0.239	0.630	0.797

Source: Processed data

Table 4.4 explains that the constructs of Ethics (ETC), Compensation Conformity (COM), Leadership Style (LDS) and Fraud (FRD) produce AVE and loading factor more than 0.5. From the data, it can be concluded that the indicators used in this research are valid or have fulfilled the convergent validity.

In Table 4.5, the *discriminant validity* of reflective indicator is tested using cross loading where it is stated that an indicator is declared 'valid' if the loading factor of the target construct is higher than that of another construct. The table shows that the loading factor for the majority LDS indicator is higher than the other constructs.

### **Reliability Test**

The reliability of existing construct data can be measured using composite reliability. The construct is declared 'reliable' if the value of composite reliability is above 0.70. The following is the calculation of construct summarized in internal composite reliability and correlation among constructs:

**Table 4.6**  
*Internal Composite Reliability and Correlation among Constructs*

	CR	ETC	COM	LDS	FRD
ETC	0.778	<b>0.758</b>			
COM	0.876	0.533	<b>0.747</b>		
LDS	0.866	0.641	0.360	<b>0.779</b>	
FRD	0.776	0.595	0.295	0.570	<b>0.767</b>

Source: Processed data

Note: the bold elements on the main diagonal are the square root of the AVE.

ETC : Ethics

COM : Compensation Conformity

LDS : Leadership Style Gaya

FRD : Fraud

The table above shows that the value of composite reliability for all constructs is above 0.70 indicating that all constructs in the estimated model meet the discriminant validity criteria. The lowest composite reliability value is 0.876, that is, on the Compensation Conformity (COM)

### Hypotheses Testing

#### **Hypothesis 1 (H1): Ethics has a negative effect on Fraud**

Table 4.8 and Figure 4.1 show that the relationship between ethics (ETC) and fraud (FRD) is not significant with the coefficient path of -0.955 and t-value of 4.325 ( $> 1.64$ ). The result of hypothesis 1 testing gives an illustration that ethics has a negative effect on fraud. This result supports the result of the research conducted by Thoyibattun (2012) that unethical behavior can affect the occurrence of fraud, or in other words ethics has a negative effect on fraud. Thus H1 in this study, which states that ethics has a negative effect on fraud, means that if an organization has a good ethics it will minimize the tendency to commit fraud.

#### **Hypothesis 2 (H2): Compensation Conformity has a negative effect on fraud**

Table 4.8 and Figure 4.1 show that the relationship between compensation conformity (COM) and fraud (FRD) is not significant with the coefficient path of -0.033 and t-value of 1.524 ( $< 1.64$ ). The result of hypothesis 2 testing gives an illustration that compensation conformity has no effect the occurrence of fraud in an organization. This result is in accordance with the result of the research conducted by Wilopo (2006) and Zulkarnain (2013) that compensation conformity has no effect on the occurrence of fraud. Thus H2 in this study, which states that compensation conformity has a negative effect on Fraud, means that if an organization provides appropriate compensation, the tendency to commit fraud will decrease.

#### **Hypothesis 3 (H3): Leadership style has a negative effect on fraud**

Table 4.8 and Figure 4.1 show that the relationship between leadership style (LDS)) and fraud (FRD) is not significant with the coefficient path of -0.753 and t-value of 1.815 ( $> 1.64$ ). The result of this hypothesis 3 testing gives an illustration that leadership style has a negative effect on the occurrence of fraud in



an organization. This result is in accordance with the result of the research conducted by Pramudita (2013) in which leadership style has a negative effect on fraud. Thus H3 in this study, which states that leadership style has a negative

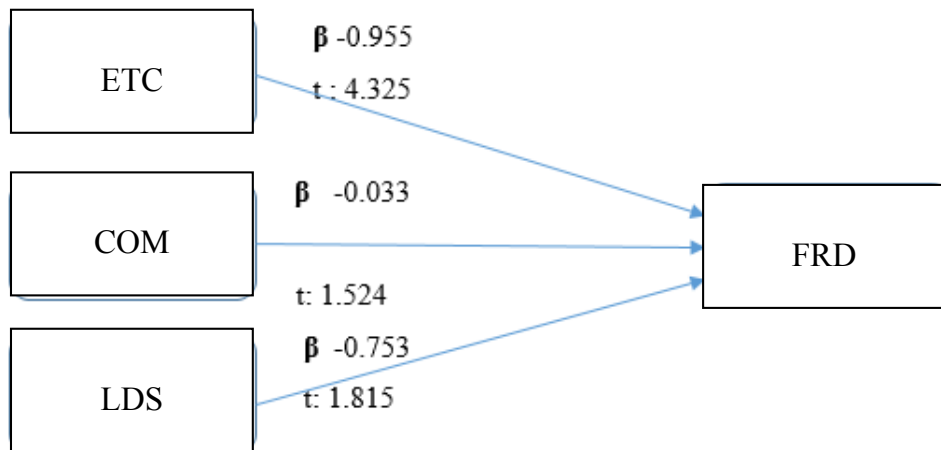
effect on the occurrence of fraud, means that if an organization has a good leadership style, it can suppress the occurrence of fraud in an organization.

**Table 4.9**  
**Conclusion of the Hypotheses**

Hypothesis	Relationship	$\beta$	t-Value	Result
H1	ETC-> FRD	-0.955	4.325	Supported
H2	COM -> FRD	-0.033	1.524	Supported
H3	LDS -> FRD	-0.753	1.815	Supported

Source: Processed data

**Figure 4.1**  
**Result of the Research**



## 6. CONCLUSION AND SUGGESTION

### Conclusion

From the results of the discussion in this study, it can be drawn conclusion as follows:

1. Ethics has a negative effect on fraud, which means that if an organization has good ethics, the tendency to commit fraud will be less.
2. Compensation conformity has a negative effect on fraud, which means that if the compensation is appropriate, the desire to commit fraud will be reduced.

3. Leadership style has a negative effect on fraud, which means that if the leadership style is good, it can suppress the desire of the subordinates to commit fraud.

### Suggestion

Here are some suggestions that can be put forward for further researchers:

1. Expanding the research object on other industries as well as on other organizations so that it can be developed further.
2. Developing and adding other factors that are expected to affect the fraud

and provide additional research in the future

### Research Implication

Fraud is detrimental and should be prevented. This research is expected to provide knowledge about fraud prevention and become a reference for subsequent research.

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